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Puerto Rico Convention Center District Authority; Miscellaneous Tax

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Puerto Rico Convention Center District Authority; Miscellaneous Tax

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Unenhanced Rating	BBB+(SPUR)/Stable	Affirmed
Puerto Rico Conv Ctr Dist Auth Auth hotel occupancy		
Unenhanced Rating	BBB+(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services has affirmed its 'BBB+' rating on Puerto Rico Convention Center District Authority's hotel occupancy tax revenue bonds series A. The outlook is stable.

The rating reflects our opinion of the following credit factors:

- A gross revenue pledge of hotel occupancy taxes levied on all hotels on the island and collected by the Puerto Rico Tourism Co., with strong enforcement procedures contributing to historically high collection rates;
- Strong historical coverage of projected maximum annual debt service (MADS) at 1.98x;
- Bond provisions that include a debt service reserve funded at MADS and a 1.40x historical revenue additional bonds test, as well as a nonimpairment covenant that protects the revenue stream from being altered or eliminated as long as the bonds are outstanding; and
- A diverse island tourism industry, which has contributed to the growth of new hotels, steady room demand by U.S. travelers, solid occupancy rates, and what we believe is sustainable annual growth.

Factors that in our opinion constrain the rating include:

- The provisions of section 8, VI of the Puerto Rico constitution, which provide that the pledged revenues are available to be applied to the payment of commonwealth general obligation (GO) debt, if other general revenue is insufficient;
- A pledged revenue stream subject to volatility due to its dependence on the tourism industry;
- Moderate concentration by hotel vendors, with casino hotels accounting for approximately 61.7% of the pledged tax.

The bonds are secured by a gross revenue pledge of the hotel occupancy tax levied on all hotels and motel accommodations on the island. Bond provisions require a debt service reserve, funded with bond proceeds at MADS, and an additional parity bonds test requiring 1.4x historical revenue coverage of MADS on outstanding and proposed bonds. A nonimpairment clause in the trust agreement covenants that as long as bonds are outstanding, the commonwealth will not reduce or eliminate the hotel occupancy tax or impair the ability of the authority to comply with its obligations to bondholders. Debt service payments have a first lien on revenue. The bonds mature on July 1, 2036.

Hotel occupancy taxes have been collected by the commonwealth since the 1960s. The tax act of 2003 created the legal framework to issue the bonds and shifted responsibility to collect the tax to the Puerto Rico Tourism Co. from the treasury. Hotels pay three different tax rates; casino hotels pay the highest rate and account for approximately 62% of revenues. In our opinion, hotel taxpayers are concentrated, with the leading 10 hotels accounting for approximately half of hotel tax revenue collections. In our view, somewhat mitigating this concentration are the island's isolation and lack of competing hotels in nearby jurisdictions. Recent revenue trends have exhibited resilience to the economic downturn, in our opinion. Collections have exhibited sustained growth since fiscal 2009, reaching $60.1 million in fiscal 2012, which equates to an annual average growth rate of 5.8%. Commonwealth officials project continued growth in fiscal 2013, with tax collections increasing to $62.8 million, or 4.5% relative to fiscal 2012.

In our opinion, the demand for hotel rooms has remained relatively stable, with nonresident travelers accounting for approximately 66% of Puerto Rico hotel registrations. We believe the strength of the island's tourism sector has played an important role in pledged tax collections. Room occupancy has remained at above 64% since 2006, despite a 9.2% increase in available room nights to 4.6 million in fiscal 2012. Average room rates have increased 10.4% in the past two years to $130.35 in fiscal 2012. In our opinion, Puerto Rico remains an attractive destination for hotel development, as evidenced by the continued increase in available rooms on the island.

The Puerto Rico Tourism Co. assumed the authority for and responsibility of collecting tourism occupancy taxes in fiscal 2005. The tourism company is required to transfer hotel occupancy tax revenues on a monthly basis to a segregated account at Government Development Bank for Puerto Rico (GDB) held on behalf of the authority for the benefit of bondholders. While the occupancy revenues are subject to the provisions of section 8, VI of the constitution, which provide that the revenues are available to be applied to the payment of commonwealth GO debt, hotel occupancy tax revenues are not included in the general fund budget.

Outlook

The stable outlook reflects our expectation of continued sound demand for hotels in Puerto Rico, and stability in occupancy tax revenues over the next two years. We expect that pledged revenues will continue to provide strong debt service coverage given the resiliency that Puerto Rico's tourism base has exhibited during the commonwealth's protracted recession. The stable outlook further assumes that the hotel occupancy revenues will continue not to be included in the general fund budget as a matter of operating practice, although legal provisions permit the prior use of hotel tax revenues for payment of commonwealth GO debt under unusual circumstances, if appropriated by the legislature and required for payment of GO debt service. We could lower the rating, potentially by several notches, if we lowered the GO rating on Puerto Rico to speculative-grade, which in our opinion would increase the likelihood of pledged revenues being subject to clawback to pay GO debt service.

Bond Provisions

The bonds are secured by a gross revenue pledge. The first dollars pay debt service. All hotels on the island charge the occupancy tax, which is collected pursuant to the Hotel Occupancy Tax Act including all penalties, charges, and related interest. The hotel occupancy tax requires the tourism company to transfer to the GDB, on a monthly basis, beginning with the first month of each fiscal year (July), 1/10th of the amount necessary to pay principal and interest due in that fiscal year and on July 1 of the succeeding fiscal year. The transfer is made to the GDB as soon as the 1/10th annual debt service requirement is collected, but no later than the last day of the month. Monthly transfer requirements are cumulative. Any remaining cumulative shortfall will be made up with May and June revenues. On a historical basis, approximately 18% of revenues have been collected in May and June. The GDB agrees under a pledge agreement to transfer such funds within three business days to the trustee on behalf of the authority for the benefit of bondholders.

A debt service reserve fund is required to be fully funded with bond proceeds at MADS, according to the trust agreement. To issue additional bonds, pledged revenues in the preceding fiscal year, adjusted for any changes in tax rates, must not be less than 140% of MADS on all outstanding bonds and proposed additional bonds. The tax act includes a nonimpairment covenant, whereby, as long as bonds remain outstanding, the commonwealth will not reduce or eliminate the hotel occupancy tax, or impair or alter the rights afforded to the authority to pledge the hotel occupancy tax and to comply with its obligations to bondholders. Operating costs of the financed convention center are paid from excess hotel occupancy revenues.

Occupancy Tax/Demand

The occupancy tax is levied on all hotels at a rate of 11% for casino hotels, 9% for hotels and motels not covered by other classifications, 7% on hotels authorized to operate as inns by the tourism company, and 5% on all-inclusive accommodations. According to commonwealth officials, collections have remained strong, at above 95%.

The Puerto Rico hotel industry is relatively strong, in our opinion. Puerto Rico has varied topographies compared with other islands in the Caribbean; it is home to one of the most diverse collections of natural attractions, including world-class beaches, rain forests, mangroves, caverns, aquaculture, and the world's largest radio telescope. Recreational activities include golf, tennis, water activities, and a thriving gaming industry with 19 casino hotels. Tourism is one of the strongest components of the economy, with a multiplier effect on other sectors, and considered one of the most viable growth drivers. While resident employment is relatively small compared with total island employment, tourism makes up a much larger proportion of the island's total gross domestic product.

Strong links to the U.S. economy are reflected in the mix of travelers. Travelers from outside of Puerto Rico accounted for approximately two-thirds of hotel registrations fiscal 2012.

Easy airport access and Puerto Rico's status as the gateway to the Caribbean are key demand drivers. Luis Munoz Marin International Airport is a U.S. airport, under Federal Aviation Administration and Transportation Security Administration supervision. Commonwealth officials expect that the recent concession of the airport to a private operator will contribute to an increase in the island's prominence as a tourist destination.

Tax Rates/Revenues

Puerto Rico has levied hotel occupancy taxes since the 1960s. No reliable records from the department of treasury exist for hotel occupancy tax collections before fiscal 1998. As is the case in many other jurisdictions, hotel occupancy tax collections have exhibited vulnerability to economic cycles, with a 17% decline in 2002, and a 15.1% decline in fiscal 2009. However, collections have rebounded strongly following those declines. On average, hotel occupancy tax collections have averaged a 2.9% growth rate since fiscal 2001, which has gradually improved coverage of MADS to 1.98x in fiscal 2012, from 1.67x in fiscal 2009, and 1.76x at the time of issuance of the bonds.

Related Criteria And Research

- USPF Criteria: Special Tax Bonds, June 13, 2007
- USPF Criteria: State Ratings Methodology, Jan. 3, 2011